

GENERAL COUNSEL MEMORANDUM

Issue: Sales Tax on Utility Costs Paid by Banks, Financial Institutions

Statute Ref: D.C. Official Code § 47-2005(11)

March 25, 2002

ISSUE:

Is electronic processing by a bank (Bank) of customers' financial information "processing" within the meaning of D.C. Official Code (Code) § 47-2005(11)?

CONCLUSION:

Since electronic processing by the Bank of customers' financial information does not transform and reduce subject matter to a different state or form from that in which they originally existed, electronic processing of customer information is not "processing" within the meaning of Code § 47-2005(11).

FACTS:

The Bank uses electronic processing to accumulate, account for and dispense customer information. The Bank filed an application for a specific exemption from sales taxes for the electricity used in the electronic processing.

LAW:

§ 47-2005. Exemptions

Gross receipts from the following sales shall be exempt from the tax imposed by this chapter:

(11) Sales of natural or artificial gas, oil, electricity, solid fuel, or steam, directly used in manufacturing, assembling, processing, or refining; * * *

9 D.C. Municipal Regulations (DCMR) § 444.4 (1954) provides, in part,

The following are examples of manufacturing, assembling, processing and refining:

- (a) Manufacturing-production of ice or fabrication of ornamental iron railing, furniture, awnings;
- (b) Assembling-assembly of radios, electric signs, truck bodies;
- (c) Processing-cooking in a cannery or restaurant, pasteurizing milk; and
- (d) Refining-production of gasoline or fuel oil in an oil refinery.

9 DCMR § 444.6 (1954) provides:

Natural or artificial gas, oil, electricity, solid fuel or steam are subject to tax if consumed in administrative or commercial phase of the business activities listed in § 444.5, such as general offices, plant cafeterias (other than processing food), sales and display rooms, retail outlets, garages where trucks for off-premises sales of products are stored and services, and similar uses.

TAXPAYER’S ARGUMENT:

The taxpayer states that the statute does not define “processing” and does not limit processing to tangible personal property. The taxpayer argues the processing of the Bank customers’ financial information is processing within the meaning of the statute.

To rebut OTR’s argument that the District’s statutory exemption is limited to processing of tangible personal property, the taxpayer relies on *Freedom Broadcasting of Tennessee, Inc. v. Tennessee Department of Revenue*, 2002 Tenn. App. LEXIS 10 (CA Tenn. 2002). In that case, the Court of Appeals of Tennessee held that the electricity as well as broadcast signals were tangible personal property within the meaning of the Tennessee statute since electricity and broadcast signals are capable of measurement and are perceptible to the senses.¹

OTR’S ARGUMENT AND POSITION:

Generally, statutes granting tax exemptions are construed strictly against the taxpayer. D.C. Official Code § 47-2005(11) exempts from District sales tax sales of electricity used in processing.

Generally, definitions of “manufacturing” and “processing” imply essentially a transformation or conversion of material or things into a different state or form from that in which they originally existed -- the actual operation incident to changing them into marketable products. Examples given are the slaughtering of livestock, the milling of grain and the spinning of cotton. See *Schumacher Stone Co. v. Tax Commission*, 134 Ohio St., 529, 534, 18 N.E. (2d), 405, 407, 120 A.L.R., 1199;² *Huron Fish Co. v. Glander, tax Commr.*, 146 Ohio St., 631, 67 N.E. (2d), 546;³ *Corn Products Refining*

¹Tennessee Code § 67-6-102(29) defines tangible personal property as personal property, which may be seen, weighed, measured, felt, or touched, or is in any other manner be perceptible to the senses. Under the Tennessee statute, for the Tennessee industrial machinery tax exemption to apply, the equipment must be used (1) primarily to fabricate or process tangible personal property, (2) for resale and ultimate consumption off the premises for the taxpayer, and (3) the fabricating or processing of the tangible personal property must be the taxpayer’s principal business.

²Crushing and screening of limestone into various merchantable sizes held not “processing.” The Court noted that, after the crushing and screening, there was still stone but in different sizes. No transformation.

³The netting of fish is not “processing.” The fish net retained marketable fish but permitted the small fish to escape.

Co. v. Federal Trade Commission (C.C.A. 7), 144 F. (2d), 211, 219; *Moore et al., State Tax Commission, v. Farmers Mutual Mfg. & Ginning Co.*, 51 Ariz., 378, 382, 77 P. (2d), 209, 211; and *Colbert Mill & Freed Co. v. Oklahoma Tax Commission*, 188 Okla., 366, 368, 109 P. (2d), 504, 506.

In *Linwood Stone Products Company, Inc., v. State Department of Revenue*, 175 N.W.2d 393 (Iowa Sup.Ct., 1970), the Court defined "processing" as an operation whereby raw material is subjected to some special treatment by artificial or natural means which changes its form, context, or condition, and results in marketable tangible personal property. For other definitions of "processing", see *Cochrane v. Deener*, 94 U.S. 780, 788, 24 L. Ed. 139, 141; *National Tube Co. v. Glander*, 157 Ohio St. 407, 410, 105 N.E.2d 648, 650⁴; *State v. Four States Drilling Co.*, 278 Ala. 273, 177 So.2d 828, 831.⁵ Also see 34 Words and Phrases, p. 261, and pocket parts; annotation 30 A.L.R. 2d 1439-1460. In *Cochrane, supra*, the United States Supreme Court defined processing as "a mode of treatment of certain materials to produce a given result. It is an act, or a series of acts, performed upon the subject-matter to be transformed and reduced to a different state or thing."

It is the position of OTR that the Bank provides a service of electronically accumulating and accounting for the Bank customers' financial information. It is the position of OTR that the Bank's service does not meet the processing standard set out in *Cochrane, supra*. There is no transformation or reduction of subject matter to a different state or thing. The Bank manipulates mass data into meaningful information without transforming or reducing the mass data into a different state or thing which changes its form, context, or condition, and results in marketable tangible personal property. The data mass is accumulated to provide financial information meaningful to the individual customer of the Bank. No marketable tangible personal property results. The data mass remains the same; numbers have been rearranged to serve the Bank's customers. There is no change of form, context, or condition that results in marketable tangible personal property as required by *Linwood Stone Products Company, supra*. There is no transformation into a different state from the original.

In *Elias Brothers Restaurants, Inc., v. Michigan Department Of Treasury*, 452 Mich. 144; 549 N.W.2d 837 (SC MI 1996) the court cited the Michigan code that defined an industrial processor is one who transforms, alters, or modifies tangible personal property. MCL 205.94(g). The court defined industrial processing to mean, "...changing the form, composition, or character of the property."

⁴ Removing iron ore and limestone from the holds of ships in substantially the same form in which they were taken from the mines or quarries not "processing."

⁵ Separation of the various matters that are in the crude, the gas and the water and the oil and the sand are processing. Transformation of crude into gas, water, sand and oil.

In *Armco, Inc. V. Lindley*, 1985 Ohio App. Lexis 8459, the court stated “processing” means the transformation or conversion of material or things into a different state or form from that in which they originally existed.

In *Byrd & Frederickson, Inc. v. Forst*, 33 Va. Cir. 496; 1974 Va. Cir. LEXIS 47, the court followed the definition of “processing” stated by the Supreme Court of Ohio in *Gressel Produce Co., Inc., v. Kosydar*, 297 N.E.2d 532; 1973 Ohio LEXIS 369; 63 Ohio Op. 2d 314---

“Manufacturing” or “processing” means the transformation or conversion of material or things into a different state or form from that in which they originally existed. *See* 297 N.E.2d at 534.

The Virginia court in *Byrd & Frederickson*, stated:

Viewing the Virginia statute in the light of the authoritative interpretation of the Ohio statute, at the time Virginia's statute was adopted, the Court must conclude that the applicant starts with raw materials (unsalable apples) at the plant site and by the use of the machinery here involved, converts the apples into a product which is a finished or completed product for sale. *See* 33 Vir. Cir. at 500.

It is the position of OTR that taxpayer reliance on *Fredon Broadcasting of Tennessee, Inc. v. Tennessee Department of Revenue*, *supra*, is without merit.

Under D.C. Code § 47-1521(4), “tangible personal property” means tangible goods and chattels used or held for use in any business, activity, or occupation whether or not operated for profit.

The District statute does not include the Tennessee statute’s proviso that tangible personal property is personal property, “which may be seen, weighed, measured, felt, or touched, or is in any other manner be perceptible to the senses.” The District follows the generally accepted definition of “tangible personal property” that is included in *Black’s Law Dictionary* [5th Ed.]: property such as a chair or watch which may be touched or felt in contrast to a contract. *Black’s Law Dictionary* also defines “tangible property” as “that which may be felt or touched, and is necessarily corporeal,”⁶ although it may be either real or personal.⁷

Since electricity is not corporeal, i.e., does not have a physical material body, electricity is not tangible personal property within the meaning of the District statute.

The taxpayer’s 9 DCMR 444.5 argument is also without merit. 9 DCMR 444.6 provides that 9 DCMR 444.5 does not apply if the utilities are consumed in the administrative or

⁶ Merriam-Webster’s Collegiate Dictionary, 10th Ed. defines as having, consisting of, or relating to a physical material body.

⁷ *Black’s Law Dictionary*, 5th Ed (1979).

commercial phase of the business. On the basis of the taxpayer's facts, the electricity used by the Bank is consumed in the administrative phase of the taxpayer's business.

CONCLUSION:

Neither the District Code nor the DCMR define "processing."

Judicial authorities have, without exception, defined "processing" to mean the transformation or conversion of material or things into a different state or form from that in which they originally existed.

The Bank provides a service by electronically accumulating and accounting for the Bank customers' financial information. There is no transformation. The Bank starts with data, manipulates the data and the final product is the same data in a different sequence.

Analogous to the Bank's activity is the crushing of rock into smaller rock. The court in *Schumacher Stone Co. v Tax Commission, supra*, held there was no transformation, the business started with rock and ended up with rock. The court held that since nothing was transformed there was no "processing."

In 1995, the Office of Finance and Revenue issued an audit ruling on similar facts and circumstances. That 1995 ruling held that the operations of a Bank are multi-faceted and predominately service-oriented and that these activities do not constitute "processing" within the meaning of the District statute. That 1995 ruling concluded: the mere production of documents through data-processing which is incidental to the providing of banking services does not constitute "processing" as contemplated by the Code.

Any OTR guidance or rulings issued that are contrary to this 1995 OTR ruling and this General Counsel Memorandum should be revoked or withdrawn.

#